

Message Text

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PAGE 01 LIMA 02021 01 OF 02 081252Z

ACTION ARA-14

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COME-00 FRB-01 INR-10 NSAE-00 XMB-04 OPIC-06

LAB-04 SIL-01 L-03 DOE-11 SOE-02 AGRE-00 ITC-01

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FM AMEMBASSY LIMA

TO SECSTATE WASHDC 9042

UNCLAS SECTION 1 OF 2 LIMA 2021

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SUBJECT: UPDATE OF INVESTMENT CLIMATE STATEMENT

REF: (A) 77 STATE 244738, (B) LIMA 0913

1. SUMMARY: GOP IN GENERAL HAS SPOKEN INCREASINGLY IN PUBLIC IN FAVOR OF FOREIGN PRIVATE DIRECT INVESTMENT (FPDI) AND HAS TAKEN A FEW CONCRETE STEPS TO ATTRACT NEW INVESTORS. HOWEVER, NEW LEGISLATION AND OTHER MEASURES TO PROMOTE FOREIGN INVESTMENT HAVE NOT YET OVERCOME INVESTOR CAUTION THAT DEVELOPED DURING THE "FIRST PHASE" OF THE MILITARY'S REVOLUTIONARY GOVERNMENT. PONDEROUS BUREAUCRACY FREQUENTLY DISHEARTENS POTENTIAL INVESTORS AND ANDEAN COMMON MARKET DECISION 24, WRITTEN INTO PERUVIAN LAW, IS ALSO CONSIDERED A DISINCENTIVE DESPITE SOME RECENT LIBERALIZING MODIFICATIONS. PRESENT ECONOMIC CRISIS, WITH ZERO OR NEGATIVE GDP GROWTH AND CONSEQUENT DECLINE IN CONSUMER BUYING POWER, DOES NOT CREATE FAVORABLE CLIMATE FOR FPDI AIMED AT PERUVIAN MARKET, THOUGH GOVERNMENT DESIRES TO STIMULATE MINERAL AND PETROLEUM DEVELOPMENT AND NON-TRADITIONAL EXPORTS MAY MAKE THESE AREAS ATTRACTIVE FOR NEW INVESTMENT. THE FOLLOWING REPORT IS KEYED TO THE UNCLASSIFIED

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PAGE 02 LIMA 02021 01 OF 02 081252Z

TOPICS OUTLINED IN PARA 2 REFTEL. END SUMMARY.

2. GENERAL GOVERNMENT ATTITUDE. SINCE EARLY 1976 THE GOVERNMENT OF PERU, IN BOTH ITS PUBLIC STATEMENTS AND ITS LEGISLATION, HAS INDICATED AN INCREASINGLY FAVORABLE ATTITUDE TOWARD FOREIGN PRIVATE DIRECT INVESTMENT. IN CONTRAST TO THE RHETORIC OF THE "FIRST PHASE" OF THE

PERUVIAN REVOLUTION, WHEN FOREIGN INVESTORS, ESPECIALLY FROM THE UNITED STATES, WERE VIEWED WITH SUSPICION AND HOSTILITY, THE GOP IN RECENT MONTHS HAS REPEATEDLY STATED THAT PERU'S DEVELOPMENT NEEDS FOREIGN INVESTMENT INPUT. MORE CONCRETELY, THE GOP HAS REVISED SOME OF THE MAJOR LAWS AND REGULATIONS IN AN EFFORT TO DRAW NEW INVESTORS TO PERU. THE PRINCIPAL LAW CONCERNING THE INDUSTRIAL SECTOR, THE GENERAL LAW OF INDUSTRIES, WAS MODIFIED IN FEBRUARY 1977 TO REDUCE THE MANAGEMENT AND OWNERSHIP ROLE OF WORKERS IN INDUSTRIAL ENTERPRISES. (77 LIMA 0887). IN JULY 1976 THE GOP REVISED THE LEGISLATION GOVERNING INVESTMENT IN PETROLEUM EXPLORATION AND EXPLOITATION IN AN EFFORT TO ATTRACT FOREIGN OIL COMPANIES FOR JUNGLE AND CONTINENTAL SHELF EXPLORATION. (76 LIMA 6761). THE GOP HAS ALSO INDICATED THAT IT WILL BE MORE FLEXIBLE THAN IN THE PAST WHEN NEW PETROLEUM CONTRACTS ARE NEGOTIATED. FURTHER POSITIVE CHANGES HAVE BEEN THE LIBERALIZATION OF THE FOREIGN EXCHANGE SYSTEM AND THE ESTABLISHMENT OF THE COMISION NACIONAL DE INVERSIONES Y TECNOLOGIAS EXTRANJERAS (NATIONAL COMMISSION FOR FOREIGN INVESTMENTS AND TECHNOLOGIES - CONITE) AS THE GOVERNMENT'S OFFICE FOR COORDINATING ALL ASPECTS OF FOREIGN DIRECT INVESTMENT. IN RECENT MONTHS THE ORGANIZATION HAS DEVELOPED A REPUTATION FOR TAKING AN EVEN-HANDED APPROACH IN HANDLING FOREIGN INVESTMENT CASES. IN DECEMBER 1977 CONITE ISSUED NEW REGULATIONS WHICH GREATLY FACILITATE PROFIT AND

UNCLASSIFIED

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PAGE 03 LIMA 02021 01 OF 02 081252Z

ROYALTY REPATRIATION AND REINVESTMENT. (LIMA 0477).

3. IN CONTRAST TO THESE POSITIVE DEVELOPMENTS THERE ARE A NUMBER OF OTHER FACTORS WHICH TEND TO DISCOURAGE BOTH POTENTIAL INVESTORS AND THOSE ALREADY HERE, AND WHICH, AT THE PRESENT MOMENT, SEEM TO OVERSHADOW THE GOP'S ATTEMPTS TO ATTRACT NEW INVESTMENT. THE OVERRIDING CONSIDERATION IS THE COUNTRY'S RECESSED ECONOMY, WITH ZERO OR NEGATIVE GDP GROWTH EXPECTED IN 1978 AND LITTLE LIKELIHOOD OF A QUICK RECOVERY. IN ADDITION THERE IS A GENERAL LACK OF CONFIDENCE THAT THE CURRENT ECONOMIC RECOVERY PROGRAM WILL BE MAINTAINED CONSISTENTLY FOR AN EXTENDED PERIOD. MOREOVER, THE LIBERALIZING STEPS TAKEN BY THE GOP ARE OFTEN OUTWEIGHED BY RED TAPE WHICH HAS NOT YET BEEN ELIMINATED AND BY A BUREAUCRACY UNACCUSTOMED TO SERVING THE PUBLIC (COMPOUNDED IN SOME CASES BY BUREAUCRATS LEFT OVER FROM THE "FIRST PHASE").

4. ECONOMIC FACTORS. PERU'S ABUNDANT ENERGY RESOURCES, WHICH INCLUDE PETROLEUM, HYDROELECTRIC POWER AND COAL, ARE FOR THE MOST PART STILL UNTAPPED AND IN SOME AREAS, ESPECIALLY OUT OF THE LIMA-CALLAO POPULATION CENTER,

SUPPLY IS ALREADY FALLING SHORT OF DEMAND. SIMILARLY, TRANSPORTATION AND COMMUNICATION INFRASTRUCTURE OUTSIDE OF LIMA IS NOT DEVELOPED SUFFICIENTLY TO ATTRACT INVESTORS TO THOSE AREAS, DESPITE EXTENSIVE INCENTIVES OFFERED FOR ESTABLISHING INVESTMENT AWAY FROM THE CAPITAL CITY. OVER 60 DEVALUATION OF SOL VIS-A-VIS U.S. DOLLAR IN LAST 6 MONTHS MAY MAKE NON-TRADITIONAL EXPORT SECTOR (WHICH GREW BY ESTIMATED 70 PCT IN 1977 AND HAS SIMILAR GROWTH PROJECTED FOR 1978) ATTRACTIVE TO INVESTORS.

5. FINANCIAL INCENTIVES AND DISINCENTIVES. AS NOTED ABOVE CERTAIN DISINCENTIVES RELATED TO RESTRICTIVE EXCHANGE AND PROFIT REPATRIATION CONTROLS HAVE BEEN REDUCED IN RECENT MONTHS. HOWEVER, UNDER THE ANDEAN PACT RULES, ANNUAL UNCLASSIFIED

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PAGE 04 LIMA 02021 01 OF 02 081252Z

PROFIT REPATRIATION IS STILL LIMITED TO 20 PCT OF FOREIGN CAPITAL INVESTED IN A COMPANY (ALTHOUGH THIS CAN BE INCREASED IN CERTAIN CASES). APART FROM ITS ANDEAN PACT COMMITMENT, PERU HAS INCENTIVES TO ATTRACT INVESTMENT TO PRIORITY INDUSTRIES AND TO PROMOTE DECENTRALIZATION. "BASIC" INDUSTRIES (IRON AND STEEL, BASIC CHEMICALS, FERTILIZERS, CEMENT, NON-FERROUS MINERALS, PULP AND PAPER, AND PRODUCERS OF CERTAIN CAPITAL GOODS) LOCATED IN LIMA PAY ONLY 20 PCT OF NORMAL TARIFFS FOR IMPORTED RAW MATERIALS, 15 PCT ON IMPORTED CAPITAL GOODS AND ARE EXEMPT FROM TAXES ON UP TO 85 PCT OF REINVESTED PROFITS. IF LOCATED OUTSIDE OF LIMA THE PERCENTAGES ARE 15 PCT, 8 PCT AND 90 PCT RESPECTIVELY. FOR "SECONDARY PRIORITY" INDUSTRY (E.G. FOOD PRODUCTION, CLOTHING, HOUSING CONSTRUCTION, HEALTH, EDUCATION, ETC.) THE CORRESPONDING PERCENTAGES ARE 50 PCT, 50 PCT AND 85 PCT RESPECTIVELY FOR INVESTMENT IN LIMA AND 27 PCT, 37.5 PCT AND 85 PCT OUTSIDE OF LIMA. FOR "COMPLEMENTARY" INDUSTRIES (E.G. NON-ESSENTIAL CONSUMER GOODS) IN LIMA THE PERCENTAGES ARE 100 PCT, 80 PCT AND 65 PCT RESPECTIVELY AND 50 PCT, 60 PCT AND 85 PCT IF LOCATED OUTSIDE OF LIMA. IN ADDITION, INDUSTRIES IN THE JUNGLE AND IN THE BORDER REGIONS RECEIVE ADDITIONAL INCENTIVES THROUGH TAX REDUCTION. PERU HAS ALSO ESTABLISHED INCENTIVES FOR NON-TRADITIONAL EXPORTS, INCLUDING TAX REDUCTIONS AND DUTY-FREE IMPORT FOR INPUTS DESTINED FOR EXPORT PRODUCTS.

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PAGE 01 LIMA 02021 02 OF 02 081516Z

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TO SECSTATE WASHDC 9043

UNCLAS SECTION 2 OF 2 LIMA 2021

6. DEVELOPMENT POLICY. THE GOP VIEWS THE MINING SECTOR AS THE AREA OF FIRST PRIORITY AND IT IS ATTEMPTING TO PROMOTE FOREIGN INVESTMENT THROUGH JOINT VENTURES IN BOTH LARGE AND MEDIUM-SCALE MINING. IN ADDITION THERE ARE EXAMPLES OF LARGE AND MEDIUMSCALE MINES THAT ARE ENTIRELY FOREIGN OWNED.

WHEREAS IN THE PAST THE GOP (THROUGH THE STATE MINING ENTERPRISE, MINERO-PERU) SOUGHT TO MAINTAIN A MAJORITY INTEREST IN MINING COMPANIES, RECENTLY THERE APPEARS TO HAVE BEEN A RELAXATION IN THE GOVERNMENT'S NEGOTIATING DEMANDS. IN THE INDUSTRIAL SECTOR THERE IS AN EMPHASIS ON COMPANIES THAT ARE EXPORT ORIENTED, ESPECIALLY WITH RESPECT TO COMPANIES WHICH PRODUCE PRODUCTS ALLOCATED TO PERU WITHIN THE ANDEAN PACT'S SECTORAL PROGRAM OF INDUSTRIAL DEVELOPMENT. SPECIFIC FACTORS CONSIDERED BY THE GOVERNMENT IN APPROVING FOREIGN INVESTMENT INCLUDE:

- (A) THE TECHNOLOGY USED;
- (B) THE POSSIBILITY OF EXPORTING TO THIRD COUNTRIES;
- (C) DECENTRALIZATION;
- (D) EMPLOYMENT GENERATION (LABOR INTENSIVE INDUSTRIES OBTAIN PREFERENCES);
- (E) IMPORT SUBSTITUTION AND UTILIZATION OF LOCAL INPUTS; AND
- (F) LOCAL VALUE ADDED.

7. LABOR FACTORS. PERU HAS A LARGE POOL OF UNSKILLED LABOR AND

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PAGE 02 LIMA 02021 02 OF 02 081516Z

CONSEQUENTLY PROVIDES INCENTIVES TO INVESTMENT IN LABOR INTENSIVE ACTIVITIES. HOWEVER, POTENTIAL INVESTORS MUST FACE A LACK OF SKILLED LABOR AND A PAUCITY OF BROAD MANAGERIAL TALENT. CONSIDERABLE NUMBERS OF PERUVIANS WITH MIDDLE AND UPPER LEVEL MANAGEMENT TRAINING/EXPERIENCE LEFT PERU DURING THE "FIRST PHASE" AND HAVE NOT SHOWN MUCH INTEREST IN RETURNING. MOREOVER, PERUVIA

LEGISLATION, WHICH INTER ALIA PROHIBITS COMPANIES FROM CONSIDERING THE PORTION OF SALARIES ABOVE ROUGHLY \$1000 PER MONTH AS AN OPERATING COST, INHIBITS TRAINED MANAGERS FROM OTHER COUNTRIES FROM SETTLING IN PERU.

8. ANOTHER FACTOR AFFECTING LABOR CONDITIONS IS PERU'S LABOR STABILITY LAW. AFTER COMPLETING A PROVISIONAL THREE-MONTH PERIOD, A WORKER CAN ONLY BE FIRED IF HE HAS COMMITTED A SERIOUS ERROR OR IF THERE IS A GENERAL REDUCTION OF THE WORK FORCE AS A RESULT OF TECHNICAL OR ECONOMIC CAUSES. THE TERMINATION OF ANY WORKER'S SERVICES FROM A COMPANY REQUIRES APPROVAL FROM THE LABOR MINISTRY. IN THE PAST THIS LEGISLATION HAS TENDED TO DISCOURAGE NEW INVESTMENT, BUT SOME INVESTORS BELIEVE THAT INTERPRETATION OF THE LEGISLATION IS BEING MODIFIED AND THAT THE LEGISLATION ITSELF MAY BE AMENDED IN THE FUTURE.

9. OWNERSHIP POLICY AND INVESTMENT DISPUTES. WITH THE RESOLUTION OF THE MARCONA AND GULF EXPROPRIATIONS, PERU HAS NO MAJOR OUTSTANDING BUSINESS DISPUTES WITH U.S. COMPANIES. HOWEVER, UNRESOLVED EXPROPRIATIONS OF THE DAILY NEWSPAPERS AND CEMENT FACTORIES (NON-FOREIGN OWNED) ARE ADDITIONAL FACTORS DISCOURAGING LOCAL INVESTORS. THE INDUSTRIAL COMMUNITY LAW, CITED EARLIER, HAS BEEN MODIFIED, BUT IT STILL PROVIDES FOR WORKER PARTICIPATION IN MANAGEMENT AND PROFIT-SHARING WHICH ARE VIEWED AS DISINCENTIVES. UNDER PERU'S ANDEAN PACT COMMITMENTS, ALL FOREIGN ENTERPRISES ENGAGING IN SUBSTANTIAL TRADE WITHIN THE ANCOM MUST TRANSFORM TO NATIONAL ENTERPRISES (I.E. 51 PERCENT NATIONALLY OWNED) WITHIN UNCLASSIFIED

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PAGE 03 LIMA 02021 02 OF 02 081516Z

15 YEARS. PERUVIAN LAW HAD EARLIER ALSO CONTAINED TRANSFORMATION REQUIREMENTS FOR COMPANIES WHICH WERE NOT OPERATING WITHIN THE ANDEAN MARKET, BUT THE LAW HAD BEEN AMENDED SO THAT COMPANIES CAN NOW REQUEST NULLIFICATION OF EXISTING TRANSFORMATION AGREEMENTS.

10. OPIC HAS CURRENCY INCONVERTIBILITY GUARANTEE POLICIES WITH A FEW COMPANIES OPERATING IN PERU WHICH DATE FROM THE MID-50'S. APART FROM THESE POLICIES OPIC HAS NOT BEEN ACTIVE IN PERU IN RECENT YEARS. OPIC HAS MAINTAINED INFORMAL CONTACTS WITH SOME GOP OFFICIALS IN HOPE OF EVENTUALLY ESTABLISHING A BROADER OPIC PROGRAM IN PERU.

11. POSSIBLE SIGNIFICANT CHANGES IN LEGISLATION. LEGISLATIVE DEVELOPMENTS OVER THE LAST TWO YEARS INCLUDING MODIFICATIONS AND NEW INTERPRETATIONS INDICATE A TREND TENDING TO FAVOR FOREIGN INVESTMENT. THE GOP HAS INDICATED THAT A NEW GENERAL INDUSTRY LAW WILL BE PROMULGATED IN THE FUTURE (NO TIME HAS BEEN GIVEN) AND BASED ON THE TREND OF RECENT YEARS, IT IS EXPECTED THAT THE NEW LAW WILL PROMOTE INVESTMENT. (FOR EXAMPLE, IT IS RUMORED THAT THE PERCENTAGE OF WORKER PARTICIPATION IN MANAGEMENT WILL BE FURTHER REDUCED.) THERE HAS ALSO

BEEN AN EXPECTATION FOR MORE THAN A YEAR THAT THE LABOR STABILITY LAW WILL BE MODIFIED. THE GOP IS IN THE PROCESS OF DRAFTING LEGISLATION THAT WILL STIMULATE INVESTMENT IN GOLD MINING.

12. STATISTICAL INFORMATION. RELIABLE STATISTICAL DATA ON BOOK VALUE OF FOREIGN INVESTMENT IS NONEXISTENT. CONITE IS ATTEMPTING TO COMPILE THESE STATISTICS BUT ITS OFFICIALS HAVE TOLD US THEY WON'T FINISH THE PROJECT FOR SOME TIME TO COME. OUR CONTACTS IN THE AMERICAN CHAMBER OF COMMERCE, LOCAL ACCOUNTING FIRMS, BANKS AND MAJOR U.S. CORPORATIONS CONFIRM THE UNAVAILABILITY OF GOOD STATISTICAL INFORMATION. KNOWLEDGEABLE OBSERVERS, HOWEVER, ESTIMATE BOOK VALUE OF FOREIGN DIRECT PRIVATE INVESTMENT IN PERU AT \$2.5 TO \$3 BILLION, OF WHICH APPROXIMATELY 65 PERCENT IS U.S. MAJOR U.S. INVESTMENT HERE IS IN MINERAL EXTRACTION (SOUTHERN PERU COPPER CORPORATION - APPROXIMATELY \$1 BILLION) AND UNCLASSIFIED

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PAGE 04 LIMA 02021 02 OF 02 081516Z

PETROLEUM EXPLORATION AND PRODUCTION (OCCIDENTAL PETROLEUM CORPORATION - ROUGHLY \$210 MILLION - AND BELCO PETROLEUM CORPORATION ABOUT \$150 MILLION.)

13. CONCLUSION. ALTHOUGH THE GOP HAS MODIFIED ITS PUBLIC STATEMENTS TO INDICATE A FAVORABLE ATTITUDE TOWARD FOREIGN PRIVATE INVESTMENT AND HAS TAKEN SOME CONCRETE STEPS IN SUPPORT OF ITS EXPRESSED POLICY, THE LACK OF CONFIDENCE GENERATED IN INVESTORS DURING THE "FIRST PHASE" OF THE REVOLUTION, THE UNCERTAINTY OF THE POLICY TO BE FOLLOWED SUBSEQUENT TO A RETURN TO CIVILIAN RULE, AND THE RECESSED ECONOMY ALL CONTRIBUTE TO CREATE A CLIMATE THAT DISCOURAGES INVESTMENT. HOWEVER, INCENTIVES FOR CERTAIN INDUSTRIES (PARTICULARLY MINING, PETROLEUM AND NON-TRADITIONAL EXPORTS) AND THE GOP'S DESIRE (AND NEED) TO ATTRACT NEW FOREIGN CAPITAL MEAN THAT SERIOUS INVESTORS COULD POSSIBLY FIND PROFITABLE AREAS FOR THEIR INVESTMENTS IN PERU. SHLAUDEMAN

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